

**STATE OF WASHINGTON  
STATE INVESTMENT BOARD**

Audit Committee Meeting

Minutes

June 4, 2003

The Audit Committee met in open public session at 9:02 A.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive SW, Olympia, Washington.

Committee Members Present:      Mike Murphy, Chair  
   Jeff Hanna  
   George Masten  
   Bob Nakahara

Other Board Members Present:      Charlie Kaminski

Others Present:                        Joe Dear  
   Les Brodie  
   Alicia Markoff  
   Beth Vandehey  
   Kristi Walters

Paul Silver, Office of the Attorney General  
Michael Humphrey, Courtland Partners (via teleconference)

[Names of other individuals attending the meeting are not included in the minutes, but are listed in the permanent record.]

Chair Murphy called the meeting to order at 9:02 A.M.

**REVIEW AND APPROVAL OF MINUTES – MARCH 12, 2003**

**Mr. Masten moved to approve the March 12, 2003, Audit Committee meeting minutes. Chair Murphy seconded and the motion passed unanimously.**

## **INTERNAL AUDITOR REPORT**

### **Audit Recommendations Status Report**

Ms. Vandehey introduced Mr. Michael Humphrey, Courtland Partners, who was present via teleconference.

Ms. Vandehey noted a typographical error on the Committee transmittal, item 2, which should read daily valued “funds,” and a percentage correction on Courtland Partners’ report, page 2, paragraph 5, which should read “.53 percent” rather than 53 percent.

Ms. Vandehey said that two outstanding audit recommendations were completed since March: the installation of a back-up generator at the WSIB office for the information technology system, and the Board’s adoption of the Daily Valued Funds policy. Ms. Vandehey reported that two items remain. Relating to compliance oversight on the internally managed fixed income portfolio, State Street Bank is continuing to work on creating a useable internal reporting system. As an alternative, staff has discussed with Financial Control Systems services they could potentially provide to meet this audit recommendation.

Ms. Vandehey reported that the second outstanding recommendation relates to reconciliation of accounting differences between the WSIB and real estate consultant. The Committee packet contained a preliminary report from Courtland Partners. Ms. Vandehey said that the main accounting differences are due to the fact that the WSIB uses a modified cash accounting system, and Courtland uses a modified accrual market value accounting system which reflects on a current basis accrual items and unrealized value changes. Second, Courtland found significant differences with some of the real estate partnership historical accounting records, specifically related to contributions, return of capital, and distribution amounts. Courtland’s report suggests that these differences may have to do with timing or reclassification issues of which the WSIB may not have been notified, or due to WSIB staff errors. Ms. Vandehey said that staff and Courtland are working together to resolve the discrepancies. Courtland has been reviewing all partnership capital calls and distribution notices since August of 2002 on a monthly basis. WSIB staff will review all historical trade ticket records, and reconciliation of current cash records. Mr. Humphrey described plans for a communication mechanism through the investment accounting system which will help explain and address the differences between the WSIB’s and Courtland Partners’ accounting systems on a monthly basis.

A discussion ensued regarding some of the differences noted in Courtland’s report and how the partnerships’ reporting to Courtland may play a factor. Chair Murphy stated a concern with the potential effect on performance and asked which records are used for the CAFR. Ms. Vandehey responded that the WSIB numbers are used.

Chair Murphy requested a timeframe for resolution. Mr. Humphrey said that Courtland is applying resources to work with WSIB staff to resolve the discrepancies as soon as possible. Chair Murphy directed Ms. Vandehey and Ms. Markoff to specifically look at the historical effect on the CAFR.

### **Internal Audit 2003-04, Commingled Monthly Bond Fund**

Ms. Vandehey reported on the internal audit of the commingled monthly bond fund (CMBF). Ms. Vandehey said that the CMBF was created to pool permanent fund stakeholders with similar investment needs. Ms. Vandehey provided an overview of the CMBF. The State University Fund is the only participant in the fund, with an investment of approximately \$25 million. Ms. Vandehey recommended that other funds join the CMBF or that the CMBF should be eliminated due to the staff time involved in the unitization processes. Mr. Dear stated that there is a very high likelihood that the other permanent funds will join the CMBF, and that he and Mr. Bruebaker are working toward that end.

Ms. Vandehey reported that the CMBF is in compliance with its overall objectives and guidelines. CMBF performance is reported to the Board on a quarterly basis. Ms. Vandehey said that the returns are independently calculated and accurately reflected, and that the unitization process is fine.

**Mr. Masten moved that the Committee accept Internal Audit 2003-04, Commingled Monthly Bond Fund, and forward it to the Board. Chair Murphy seconded and the motion passed unanimously.**

### **Fiscal Year 2003-04 Audit Plan**

Ms. Vandehey provided an overview of the internal audit unit, and spoke to her audit experience, projects, and affiliations. Ms. Vandehey reported that four of the five planned audits for fiscal year 2002-03 took place, and that one was extended over the summer months so that Ms. Vandehey could work with a group of her peers from the Association of Public Pension Fund Auditors in visiting common general partnerships together.

Ms. Vandehey discussed the areas considered for the current year's audits and described her selection process, which included management involvement. Ms. Vandehey said that four audits were selected for fiscal year 2003-04: the private equity unit; Financial Control Systems; the quarterly investment report; and the real estate unit. Ms. Vandehey also discussed upcoming projects within the internal audit unit.

**Mr. Masten moved that the Audit Committee recommend that the Board accept the Fiscal Year 2003-04 Audit Plan. Chair Murphy seconded and the motion passed unanimously.**

### **CODE OF CONDUCT COMPLIANCE REVIEW**

Mr. Silver said that he has not yet completed the compliance review, but hopes to have it finished prior to July. Mr. Silver reported that no statutory violations or conflicts were found. A few issues will be included in the formal memo to Chair Murphy.

Mr. Silver questioned the appropriateness of having the Office of the Attorney General (AGO) conduct the review, which is directed in Board policy. Mr. Silver said that he felt the review was

more of an audit process. Chair Murphy responded that it was important to have the review done externally from the agency, and both he and Mr. Masten were comfortable utilizing the AGO for this purpose. Mr. Silver suggested that assigning an AGO staff familiar with audit functions may be more appropriate. Chair Murphy said that the AGO could determine its own internal process for handling.

Chair Murphy said that Mr. Silver's memo would be distributed to all Committee members upon receipt and discussion would occur at the next regularly scheduled Audit Committee meeting in September.

### **BOARD CHAIR AND VICE CHAIR ELECTION PROCEDURES**

Chair Murphy advised that he had asked Mr. Dear for suggestions on Board election procedures but, upon further reflection, it was determined that this discussion would occur at the Board governance retreat in July. Mr. Dear said that the election procedures would be one of eight policies to be reviewed.

### **OTHER ITEMS**

There being no further business to come before the Committee, the meeting adjourned at 10:06 A.M.